Farm Financial Management- Keeping the Pencil Sharp
By: Jonathan Shepherd

A significant trait found in top performing farm managers is having a focused approach towards efficiency and a sharp pencil. Two things top managers focus on are working capital and cash-flow. The current agricultural production climate warrants all producers to take an even closer look at costs and returns. So far, 2014 has shown some signs of concern for grain producers with commodities trading at or below the cost of production; while livestock and dairy producers, especially cow/calf operations, may see an opportunity to improve farm equity. Regardless of what enterprise mix constitutes your farming operation, prudent farm financial management is the cornerstone of ensuring that your operation can weather a storm or efficiently allocate net worth to be productive in future years. This article will look at the importance of having adequate working capital as well as ways to address cash-flow issues.

Working capital is the difference between current assets and current liabilities, and is generated from net farm income (NFI). Current assets include cash and marketable grain/livestock inventories that will be sold within a year. Current liabilities are those that are due within one year such as operating notes, yearly principal, and accrued interest payments on term debt, etc. Increasing working capital is important so that your operation can better withstand short-run profit shortfalls, while taking advantage of opportunities as they arise.
NFI is the difference between total income and total expense, including gain or loss on capital asset sales. The difference can be thought of as the amount returned to owner equity, management, and unpaid labor. There are only four places that NFI can go: 1.) family living or partner withdrawals, 2.) income and social security tax payments, 3.) increases in assets, and 4.) decreases in liabilities through principal payments; all of which affect net worth. Number three above is where positive NFI can be used to increase working capital by retaining returns in liquid assets. Positive NFI can also be applied to number four above and still increase working capital by reducing liabilities.

With shrinking margins in grain commodities, many producers will have a lower NFI for 2014 relative to the most recent years. Concern arises when debt servicing and family living expenses are based on years of relatively high, and in some cases, record-breaking incomes. There is a good chance that balance sheets completed at the end of 2014 will not show as high of an increase in cost-basis net worth as years passed. This is where managers must sharpen their pencils and take time to analyze their operations in detail. For producers who find that they are having cash-flow issues because their working capital is not sufficient, consider the items below:

- **Debt Structure**- Do you need to restructure your debt load? If you have too much current debt, it may be advisable to restructure it and shift more to term debt. This will help alleviate some cash-flow concerns.

- **Asset Management**- Are you maximizing your assets? Think about the “big ticket items” such as tractors and combines. Are these fixed costs being spread over as many acres as possible? Or, were you hoping to “grow in to them?” If the asset is not being maximized, it may be time to sell and replace it with a more appropriately sized asset. This decision needs to be analyzed carefully. Take into consideration gains/losses and the potential for accelerated depreciation recapture before making this decision. Livestock operations need to look at underperforming assets as well. It may be time to replace or cull underperforming assets.

- **Asset Acquisitions**- Is now the best time to be purchasing new machinery and buildings? Remember, those payments are due each year, regardless of your NFI. Do not let your eyes become bigger than your balance sheet. Keep the ego and emotions in check when making these decisions.

- **Cost reduction**- Are your operating costs as low as possible? Is it possible to make repairs as opposed to purchasing new equipment? Review other costs, especially overhead costs and determine if reductions can be made.

- **Downsizing**- With shrinking margins, is it time to give up marginal land? Remember, each farm needs to be analyzed and cash rent needs to be looked at on the margins. In other words, the revenue generated off each farm needs to be compared to cost associated with generating that revenue. Calculating average cash rent for your operation can be very misleading when deciding whether to renew a lease or not. Be sure to complete an enterprise budget specific to each farm.

- **Cash rents**- Is it possible to renegotiate cash rents for 2015, or find less-costly rental agreements?

- **Family living**- Family living expenses are arguably as “sticky” as cash rents. These expenses should be analyzed as closely as farm expenses and be adjusted to correspond with NFI.

- **Have a cushion**- Having several months of living expenses on hand as well as
other liquid assets for the farming operation is not a bad thing. While there is not much return to be earned on these assets currently, self-insuring in this manner will help to safeguard your family and your farming operation against an unexpected event (major repair, illness, etc.)

For those producers who may have been dealing with cash-flow issues in the past, but are posed to increase profitability in the coming years, be cautious not to forget the lessons learned. Do not let the pencil get dull. While returns may be up for livestock and dairy producers, be judicious in making decisions concerning expanding herds. Be sure to carefully plan and budget any new capital assets to ensure that you will be able to pay for them if the cycle turns down. A great place to start with these decisions is your own, detailed, and timely kept records. If you need help analyzing these decisions, or find that you have cash-flow concerns, contact your local Kentucky Farm Business Management Specialist and see what the Kentucky Farm Business Management Program has to offer.

www.uky.edu/Ag/KFBM

Get Serious About Budgets
By: Jennifer Rogers

According to the Kentucky Farm Business Management (KFBM) program data, Kentucky grain producers have experienced record high net farm incomes over the last several years. This has been a time of “plenty” for many producers and has provided the resources to allow producers to be somewhat relaxed in their budgeting and spending. Record grain prices and incomes have also caused many costs to increase, especially in the case of land rent. Looking forward to the end of the 2014 marketing year and 2015, grain prices are not expected to be as strong, causing many producers to wonder about their profit potential. With this expected decline, budgeting for each crop becomes vitally important to the sustainability of the farm. When the budget doesn’t pencil out, some hard decisions must be made. A particular area of cost reducing opportunity may lie in the renegotiation of land rental prices.

Start with Expected Revenue
When creating a budget for the coming year it is important to start with expected revenue. Expected revenue is the money that you think you will receive for the crop when it is sold. This can be calculated by using your average historical yield and an expected sale price. If you will be storing the crop, you will need to reduce the expected sale price by the storage cost or include storage costs in your variable costs. Using realistic yield and price estimates is vital. Planning for the best scenario will not provide you with any margin if yields are not as good or if prices fall. Using prices from the Chicago Board of Trade for the next year are a good starting point, but be sure to complete your budget with considerations of those prices falling (or rising) throughout the growing season.

Calculate Variable Costs
Variable costs are the costs that you incur only if you plant the crop. These costs will include seed, fertilizer, chemicals, fuel, storage, labor and several others. Current prices from suppliers in your area should be used to calculate these costs as they vary based on your location, size and field. Variable costs may be your best opportunity to improve your expected returns. A soil sample may help you save money on fertilizer expense, or at least allow you to make the most impact with your fertility dollars. The type and variety of seed that you plant can impact seed cost dramatically.
Crop land rent is also considered a variable cost. Across the state we have seen an increase in rental prices with the increase in farm incomes. If prices fall as predicted, rental prices will likely be a key area of renegotiation to allow producers the opportunity to make a profit. A producer with a high percentage of cash rented land that has seen a significant increase over the last few years will be at risk of experiencing low or negative net crop returns. This renegotiation is likely to cause sensitive situations with landlords. Producers need to consider the impact of losing rented ground when cash rent is renegotiated.

Account for Fixed Costs
Fixed costs are those costs that you incur even if a crop is not planted. Many of these costs assume that you have land and equipment that you have been using in the past and will continue to have. Even when a piece of equipment is paid for, there is still a cost associated with it. If you plan to replace the equipment at any point in the future, the equipment should be paying a use fee with each crop that is grown. Owned land would be accounted for in a similar way. Many producers forget to account for their own labor as a cost, if the family relies on income from the farm to pay for living expenses, operator labor must be accounted for in the budget.

While budgeting is never fun, and can be disheartening when prices are going down, it is an important task to insure that a farm can make a profit and to allow for changes before the money is spent. Budgeting allows a producer to know their break-even cost and then helps to market the crop. A producer who knows the price they need, can lock in a profit making price and not have to worry about selling at the market high. If your budget reveals that you need an impossible price to make a profit, it is time to go back to the budget and find ways to save on costs, increase revenue, or to evaluate the potential of growing a different crop.

At this point, many producers are not thinking about the 2015 crop. They are still concerned with the maturing and harvesting of the 2014 crop that is still in the field. However, this fall is the time to consider input prices and application rates before prepaying expenses for next year and it is the time to meet with landlords and discuss any needed cash rent adjustments. For more information on renegotiating cash rents you may be interested in this article in the Illinois Farm Docs: [http://farmdocdaily.illinois.edu/2014/07/renegotiating-cash-rents-down-2015.html](http://farmdocdaily.illinois.edu/2014/07/renegotiating-cash-rents-down-2015.html).

Help with budgeting can be found by accessing many of the budgeting tools available through the University of Kentucky Department of Agricultural Economics website publications ([http://www2.ca.uky.edu/agecon/](http://www2.ca.uky.edu/agecon/)) or you can see your local Agriculture Extension Agent or Area KFBM Specialist.

---

**What Does the Future Hold for Cash Rents?**

By: Lauren Turley

If you have spoken with a farmer in the last month, I can almost guarantee one topic of conversation was the futures market. Cattle farmers are reaping the record high beef prices, while grain farmers are on the other side fretting, as grain prices have decreased to the lowest levels seen in several years. Grain producers have been projecting budgets for the upcoming years and realizing that something has to give. Expected returns are not high enough to cover all of the costs and provide a return to operators. Most Kentucky grain producers have realized record returns the last three years and should have built equity in that time. However, it does not make it any easier to see the negative returns that are projected for the future. There may be some cost savings in 2015 if fertilizer price declines, as is expected. Other crop input prices are not expected to decrease. One major direct cost that should be examined is land rent, most likely the largest per acre cost for producers on ground that is not owned. In western Kentucky, competitiveness has taken rents to the next level. Many rents have been negotiated on a three or five-year term, thus the producer may be locked in at that level for the upcoming years. With
slipping commodity prices, expectations would be a decline in rents going forward.

In Kentucky, from 2008 to 2013, average cash rents increased by 90%, according to USDA annual cash rent data. From 2009 to 2013, there was a 59% increase going from $93.50/acre in 2009 to $149/acre in 2013. Cash rents rose in recent years due to increases in land and operator returns, corresponding with the increased grain prices. Despite lower grain prices since fall of 2013, cash rents held steady for 2014.

Throughout history, it has been demonstrated that rents may go down, but not usually by very much and not very often. Rents that are being negotiated now will likely be lower, and rightly so. Rent should decrease because of the projected lower returns; however, commodity prices are much more volatile than cash rents and farmers are at risk of losing farmland if landlords are not willing to accept lower cash rents. It is essential for producers to realize that not farming high cash rent farmland may be the best alternative to getting in a “bidding war”. There are some cash rents that may not need to be adjusted; either as a result of the rent being relatively low, or if the cash rent has lagged behind the increase in agricultural returns. Setting the cash rent for farms is difficult as the crop price and yield are unknown when the rental agreement is made. Rents will not always correspond to actual returns.

Other options to cash rents are crop-share agreements or flex leases. In the Ohio Valley area of Kentucky, crop-share rental agreements are the dominant rental agreement. In this arrangement, revenues, and sometimes direct costs, are shared between the land owner and the farmer. The share would depend on the type and quality of ground. With this agreement, the landowner is at risk just like the farmer, but there is an opportunity for the landowner to reap in the benefits of a stronger market or better production year. This year, farmers have become very interested in flex leases. With this type of lease, there is a floor, or minimum cash rent, and an opportunity for the landowner to receive a “bonus” under various circumstances. For example, a “bonus” may be paid if the gross revenue is higher than a trigger revenue, or if yields are higher than the trigger yields. If landowners are willing to share in some of the risk associated with production agriculture, they could receive higher average returns.

Grain producers need to begin looking at budgets for the upcoming years and determining if costs can be cut. Reality is setting in and it looks like we will be seeing less than $4 corn for at least a couple of years. If rental agreements are up for renewal, conversations should be held with landlords to negotiate and talk about the options. The costs and returns should be analyzed. Cash rents have received much attention in the last couple of years, but as margins are squeezed, what will happen to cash rents is uncertain. If you have any questions about rental agreements, feel free to contact any KFBM specialist.

---

**USDA Announces Farm Bill Timeline**

By: Todd Davis

The Secretary of Agriculture has announced the timeline that landowners and farmers have to make their decisions as part of implementing the 2014 Farm Bill. Landowners are responsible for making the decisions regarding reallocating base acres and updating yields. Producers decide to elect either the ARC-County, ARC-Individual, or PLC program.

July/August 2014: Landowners received letters from FSA with information used for updating payment yield and reallocating base.

September 29, 2014 – February 27, 2015: Landowners have a one-time, irrevocable opportunity to reallocate base and update payment yields.

November 17, 2014 – March 31, 2015: Producers have a one-time, irrevocable decision to elect either (1) ARC-County or PLC on a covered-commodity by covered-commodity basis OR elect (2) ARC-Individual for all of the covered commodities on the farm.
Mid-April 2015 – Summer 2015: Producers sign contracts to participate in ARC/PLC for 2014 and 2015 crop years.

The University of Kentucky’s Cooperative Extension service will be providing several educational opportunities to inform farmers and landowners about the programs, the decisions that have to be made, and the decision tools that are available to assist in making these decisions. Meeting dates and locations are being planned. Stay tuned for more information!

Upcoming KFBM Events:

Nov. 13<sup>th</sup> 2014 Lenders Conference – Graves County Extension Office
1:00pm-4:00pm

Nov. 14<sup>th</sup> 2014 Lenders Conference – Christian County Extension Office
9:00am-12:00pm

Nov. 17<sup>th</sup> Purchase Annual Meeting – Graves County Extension Office

Nov. 18<sup>th</sup> Ohio Valley Annual Meeting – Jeri’s Café Clay, KY

Nov. 19<sup>th</sup> 2014 Lenders Conference – Henderson County Education & Expo Center 9:00am-12:00pm

Dec. 1<sup>st</sup> Pennyroyal Annual Meeting – Christian County Extension Office

Dec. 10<sup>th</sup> KFBM Winter Board Meeting – Fayette County Extension Office